

Analysis
Public Employees Retirement System
2017 Preliminary Earnings Crediting Report

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Request: Acknowledge receipt of a report on preliminary 2017 earnings crediting

Recommendation: Acknowledge receipt of the report.

Analysis: ORS 238.670(5) requires the Public Employees Retirement System (PERS) Board to submit a report to the Legislature on the Board's preliminary plan to credit calendar year earnings of the Oregon Public Employees Retirement Fund (OPERF) to member and employer accounts and other reserves. Under the statute, the Board must provide the report at least 30 days before the Board makes its final earnings crediting decision. The Board is scheduled to make its final 2017 earnings crediting decision on April 2, 2018. Statute gives the PERS Board broad authority to make earnings crediting decisions and, according to the agency, allocations have generally been on a proportional basis for member and employer accounts.

On February 2, 2018, the PERS Board approved preliminary earnings crediting for calendar year 2018 of \$10.1 billion, which is the single largest amount credited in PERS history. Allocating 2017 earnings will increase reserves subject to crediting from \$66.6 billion to \$76.7 billion for a 15.2% increase. This exceeds the assumed earnings rate of 7.2% by 8%. Earnings, however, fell slightly short of the one-year OPERF benchmark of 15.64% established by the Oregon Investment Council (OIC).

Assumed Rate Change and the Unfunded Accrued Liability

The PERS Board recently lowered the assumed rate from 7.5% to 7.2% per annum beginning retroactively with the December 31, 2016 actuarial valuation. While having no impact on 2017 preliminary earnings crediting, the change did increase the Unfunded Accrued Liability (UAL) by increasing the future costs of projected benefits. The system-wide UAL for calendar year 2016 is \$19.9 billion after taking into account \$5.4 billion in pre-paid employer side accounts. This is a \$3.7 billion net increase that is principally caused by the reduction in the assumed earnings rate. The funded status of the system is 75.4% funded, based on current PERS Board assumptions.

Employer Reserve Accounts and Oregon Public Service Retirement Program

The preliminary earnings crediting of the employer reserve account is \$3.7 billion for a balance of \$28.1 billion and a return of 15.1%. The preliminary earnings crediting for employer's Oregon Public Service Retirement Program Pension accounts is \$548.8 million for a balance of \$4.1 billion and a return of 15.4%.

Retiree Benefits

Upon an individual's retirement, funds are transferred into a Benefits-in-Force Reserve account, which is used to fund retiree benefits payments. The preliminary earnings crediting for this account is \$3.2 billion for a balance of \$24.2 billion and a return of 15.1%.

Member Accounts

The preliminary earnings crediting for Tier One member regular accounts is \$299.5 million for a balance of \$4.3 billion. Earnings crediting for this account was at the 2017 assumed earnings rate of 7.5%. The preliminary earnings crediting for Tier Two regular member accounts was \$126.7 million for a balance of \$964.4 million and a return of 15.1%. Judge Member Accounts were credited with the assumed earnings rate of 7.5%. Member variable accounts, which are invested in equities, earned 26.45% (after expenses).

Tier One Rate Guarantee Reserve

The Tier One Rate Guarantee Reserve makes up any shortfall between the assumed earnings rate and investment returns for Tier One regular accounts. Since Tier One regular account earnings were above the assumed earnings rate of 7.5%, \$331.7 million will be deposited into the account for a balance of \$512.5 million.

Individual Account Program

The preliminary crediting for the Individual Account Program (IAP) is \$1.1 billion for a balance of \$9 billion and a return of 14.45%. On September 20, 2017, an administrative decision by the Oregon Investment Council moved the IAP to a target-date fund solution beginning January 2, 2018. The target-date solution is an age-based approach that moves a member's IAP assets into an increasingly conservative investment portfolio as the member ages to help protect against market fluctuations. The OIC change will initiate a glidepath that included moving approximately \$2 billion in IAP assets into outside investors to facilitate the target-date fund structure at initial implementation. OIC's target-date solution is a mandatory change for IAP members. The target-date solution provides for no member choice to make individual investment decisions. The primary impact of this decision into the future will be the lowering of potential earnings on member contributions as the investment allocation becomes more conservative (see Item #46: Interim Joint Committee on Ways and Means [January 2018] - Individual Account Program Target-Date Fund Change). Of note is that SB 4159 was introduced in response to this action and is currently under consideration by the Legislature. This measure provides for an IAP member choice in investment selection or election beginning on January 1, 2019.

Contingency Reserve

When earnings on OPERF equal or exceed the assumed earnings rate, the PERS Board may credit up to 7.2% of earnings to the Contingency Reserve. The overfunding of the Contingency Reserve has been an issue for the Legislature beginning with the 2012 earnings crediting report. Reserve funds are not accounted for in actuarial valuations and the deployment of any amount of reserves to member regular accounts and employer accounts would reduce employer rates. The Legislature in 2017 enacted SB 1067 which statutorily limits the maximum balance of the Contingency Reserve to \$50 million. Therefore, the PERS Board made no further allocation to the Contingency Reserve and the balance is at \$50 million. To achieve this reduced balance, the Board in December of 2017 allocated \$532.7 million of excess reserve funds to the Benefits-in-Force Reserve. Rather than being allocated back to the accounts from which the earnings were originally diverted to fund the Contingency Reserve, the excess funds were deposited only into the Benefits-in-Force Reserve.

An additional statutory change in SB 1067 was to remove from the PERS Board the discretion to use the Contingency Reserve for "unspecified contingencies." Statutorily, contingency reserves are limited to pay for: (a) a deficit in the payment of retirement allowances; (b) employer insolvency; and (c) legal expenses.

Expenses

The preliminary earnings crediting for calendar year 2017 of \$10.1 billion is the net amount credited after \$497 million in calendar year investment expenses and brokerage commissions, and \$18.2 million in State Treasury expenses, and \$38.3 million for PERS agency operational expenses are deducted. The amount of administrative expenses directed by the OIC was unavailable for reporting. Expenses are funded with earnings when they are sufficient (ORS 238.601(1)). The Legislature may want to consider a closer examination of OIC and OST expenses during the 2019 session as such expenses now exceed over \$1 billion a biennium.

Future Employer Contribution Rates

Advisory employer contribution rates have been published by the PERS Board for the 2019-21 biennium and are based on 2016 actual earnings crediting and 2017 earnings at the assumed rate of 7.2%. Adopted employer contribution rates for the 2019-21 biennium will be based on final earnings crediting for calendar years 2016 and 2017. Although 2017 earnings above the assumed rate will marginally improve the system's overall funded status and would otherwise cause employers to expect a reduction in the next rate setting cycle, the PERS Board's rate collaring policy will still result in almost all employers seeing the maximum allowed increase in their employer rates. The rate collar restricted earlier rate increases that are still needed to fund the system's unfunded actuarial liability, so the 2019-21 rates will still need to increase by the maximum amount allowed.

Recommendation

The Legislative Fiscal Office recommends acknowledging receipt of the report.

Addendum-A

The following addendum summarizes actual PERS account earnings history from 1997-2017.

PERS Investment Earnings History (1997-2017)							
Years	Calendar Year	OPERF	Assumed Rate	Tier 1	Tier 2	Variable	IAP
1	1997	20.42%	8.00%	18.70%	20.42%	28.87%	--
2	1998	15.43%	8.00%	14.10%	13.63%	21.45%	--
3	1999	24.89%	8.00%	11.33%	21.97%	28.83%	--
4	2000	0.63%	8.00%	8.00%	0.54%	-3.24%	--
5	2001	-7.17%	8.00%	8.00%	-6.66%	-11.19%	--
6	2002	-8.93%	8.00%	8.00%	-8.93%	-21.51%	--
7	2003	23.79%	8.00%	8.00%	22.00%	34.68%	--
8	2004	13.80%	8.00%	8.00%	13.27%	13.00%	12.77%
9	2005	13.04%	8.00%	8.00%	18.31%	8.29%	12.80%
10	2006	15.57%	8.00%	8.00%	15.45%	15.61%	14.98%
11	2007	10.22%	8.00%	7.97%	9.47%	1.75%	9.46%
12	2008	-27.18%	8.00%	8.00%	-27.18%	-43.71%	-26.75%
13	2009	19.19%	8.00%	8.00%	19.12%	35.57%	18.47%
14	2010	12.44%	8.00%	8.00%	12.44%	15.17%	12.13%
15	2011	2.21%	8.00%	8.00%	2.21%	-7.80%	2.15%
16	2012	14.29%	8.00%	8.00%	14.68%	18.43%	14.09%
17	2013	15.76%	8.00%	8.00%	15.62%	25.74%	15.59%
18	2014	7.29%	7.75%	7.75%	7.24%	4.29%	7.05%
19	2015	2.21%	7.75%	7.75%	1.87%	-1.61%	1.85%
20	2016	7.10%	7.50%	7.50%	7.12%	8.77%	7.14%
21	2017	15.15%	7.50%	7.50%	15.12%	26.45%	14.45%

21-year	Average	9.05%	7.93%	8.89%	8.94%	9.42%	--
20-year	Average	8.49%	7.92%	8.40%	8.36%	8.45%	--
15-year	Average	9.66%	7.90%	7.90%	9.78%	10.31%	--
10-year	Average	6.85%	7.85%	7.85%	6.82%	8.13%	6.62%
5-year	Average	9.50%	7.70%	7.70%	9.39%	12.73%	9.22%
3-year	Average	8.15%	7.58%	7.58%	8.04%	11.20%	7.81%